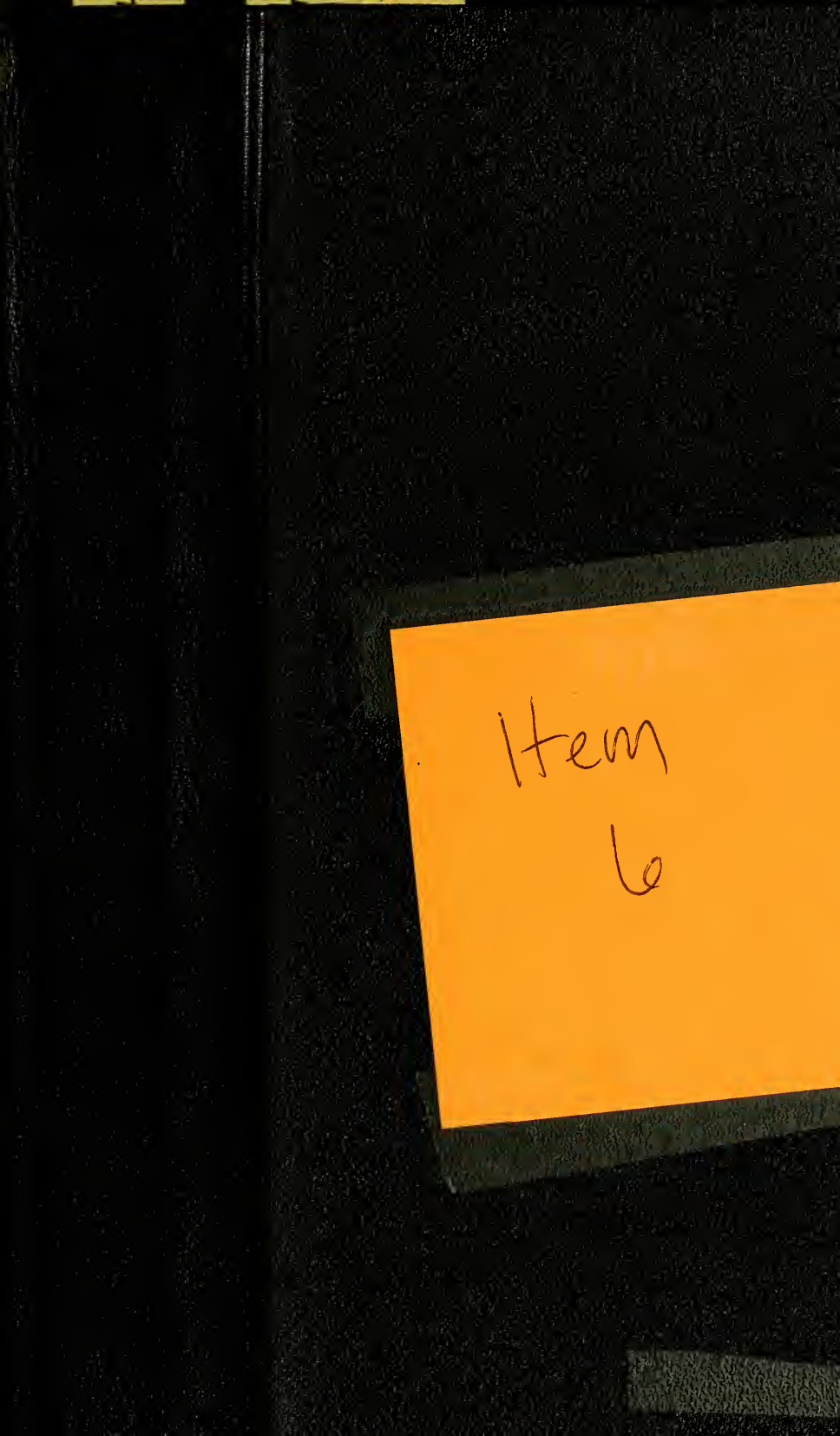
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PART 16

CAPITAL GAINS TAXATION

PREPARED BY THE

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CAPITAL GAINS TAXATION

In his statement to the Ways and Means Committee on February 5, 1951, the Secretary recommended that the maximum effective rate of tax on long-term capital gains be raised from 25 to 37½ percent and that the holding period be lengthened from 6 months to 1 year. Under the tax rates proposed by the Secretary, these changes would yield $440 million in a full year of operation.

More effective taxation of capital gains is an important part of the President's program for strengthening the individual and corporation income taxes to meet our growing defense costs on a current basis. An increased maximum rate and longer holding period would bring the capital gains tax into better alinement with taxes paid on ordinary income, would provide more effective taxation of speculative profits, and would reduce the incentive toward tax avoidance through conversion of ordinary income into capital gain.

I. THE PRESENT CAPITAL GAINS TAX PROVISIONS

The rate and holding-period provisions of the capital gains tax have been unchanged since 1942.

Short-term capital gains (from property held 6 months or less) are treated as ordinary income. Long-term capital gains of individuals are taken into account only to the extent of 50 percent in computing net income. In addition, long-term capital gains taken into account are subject to a maximum alternative rate of 50 percent. In combination with the 50-percent inclusion, this 50-percent alternative rate limits to 25 percent the maximum effective rate of tax on long-term capital gains. Under present individual income tax rates, the alternative capital gains rate is used only by individuals having surtax net income in excess of $18,000 if single and $36,000 if married and filing a joint return.

Corporations are required to include in income 100 percent of their long-term capital gains rather than only 50 percent, but like individuals, have the benefit of the 25-percent limitation on rate of tax.

II. Taxation of Gains of Speculators

The recommendation of the Secretary of the Treasury that the holding period be lengthened to 1 year is aimed primarily at more effective taxation of speculative gains.

A. DISCUSSION OF THE PROBLEM

To many persons it seems illogical and inequitable that wage earners, professional men, farmers, and merchants (including dealers in securities) must pay income taxes at full rates on their earnings, while one who earns all or a part of his income by speculating in stocks, commodities, bonds, etc., need pay only a relatively small tax on such income. Moreover, it has consistently been the policy of Congress to extend no special tax concession to speculative gains. The holding period has been the principal method used to distinguish speculation from investment.

This policy was restated and reaffirmed in the report of this committee upon the 1938 Revenue Act. Quoting from the report:

* * * the committee is also of the opinion that there is no justification for a lower tax on a speculator on the stock market than on an individual receiving a like income from salary or business.

* * * The short-term category [1 year under the committee bill] includes, in the main, speculative gains which it has been the long-settled policy of Congress to tax in the same manner and to the same extent as earned income and business profits. This policy is adhered to in the present bill. * * *[1]

Notwithstanding this traditional policy toward speculative gains, experience has shown that speculators are now obtaining large and, it is believed, unintended tax advantages.

This point may be illustrated by actual examples. The data used are taken from the income-tax returns of individuals whose principal business was that of speculation.

Example (1).—In 1948, A realized profits of $7,100,000 and losses of $4,900,000 in his trading activities, leaving him a net profit of $2,200,000. Despite this large profit averaging more than $40,000 a week, the result shown on the income-tax return of A was as follows:

Long-term capital gains	$6, 600, 000	
Amount of such gain taken into account (50 percent)		$3, 300, 000
Short-term capital losses	$4, 900, 000	
Short-term capital gains	500, 000	
Net short-term capital loss		4, 400, 000
Net capital loss		1, 100, 000

In summary, A paid no tax upon his actual profits of $2,200,000; moreover, he could carry his statutory net capital loss of $1,100,000 forward against capital gains of the succeeding 5 years.

Example (2).—During the 4 years 1944 through 1947, B made an aggregate net profit of about $1,140,000 upon his transactions in commodity futures. He paid no income tax upon these profits. After matching his losses (most of which were short-term) against his gains (most of which were long-term), his income tax returns showed statutory net capital losses aggregating about $330,000.

These examples illustrate two fundamental defects in the present tax treatment. First, although these individuals were engaged in the business of speculating, their profits were not taxed at full rates, as would be the case with any other type of business. Secondly, they did not pay even the relatively smaller capital gains tax. Their profits escaped tax completely and, in addition, their tax returns showed fictitious losses which could be carried forward against capital gains of later years.

B. REVISED METHOD OF OFFSETTING LOSSES AGAINST GAINS

The appearance of loss in the examples arises from the fact that, since long-term capital gains are only 50 percent taken into account, $1 of short-term capital loss may offset $2 of long-term capital gain. Due to the tendency to realize gains as long term and losses as short term, the situations illustrated are not uncommon.

The capital gains tax provisions applicable to corporations do not share this defect. If the taxpayer described in example (1) above—who had $6,600,000 of long-term capital gains and a net short-term

[1] Report of Ways and Means Committee (75th Cong., 3d sess., H. Rept. 1860), pp. 7, 36.

capital loss of $4,400,000—had been a corporation, the tax return would not have shown a capital loss; instead, a 25-percent tax would have been paid upon the actual gain of $2,200,000. This is due to the fact that net short-term capital loss is offset against net long-term capital gain at the ratio of 1 to 1 in the case of a corporation instead of at the ratio of 2 to 1, as in the case of an individual.

The tax advantage now being obtained by speculators can be eliminated by revising the capital gains tax provisions so that $1 of capital loss would offset only $1 of capital gain. In effect, short-term capital loss would first be offset against long-term capital gain dollar for dollar; any remaining excess of long-term capital gain would then receive the advantages of percentage inclusion and alternative rate.

The following example will illustrate the proposal. Assume that an individual realizes $2,000 of long-term capital gain and $1,500 of short-term capital loss during the taxable year. Present result: Loss, deductible against ordinary income, of $500 (the excess of the $1,500 short-term capital loss over the $1,000 of long-term capital gain taken into account). Proposed result: Gain, taxable at a rate not to exceed 50 percent, of $250 (50 percent of the excess of the $2,000 long-term capital gain over the $1,500 short-term capital loss).

This revision in the method of offsetting capital losses against capital gains would make it possible to eliminate for the future the greater part of the complex amendment relating to short sales which was enacted in the Revenue Act of 1950.

The staffs of the Treasury and the Joint Committee on Internal Revenue Taxation are in agreement on this proposed method of offsetting losses against gains.

C. PROPOSAL TO LENGTHEN THE HOLDING PERIOD

Although the suggestion just outlined would prevent the reporting of fictitious capital losses, the business of speculating in securities, commodities, or other capital assets would still receive more favorable tax treatment than other lines of business activity.

In order to subject a larger proportion of speculative gains to full rates, the Secretary recommended to your committee that the holding period separating short-term from long-term transactions be lengthened to 1 year.

It is believed that a considerably larger proportion of capital gains would become subject to full rates under this proposal. At present short-term gains are negligible as a percentage of long-term gains. For example, in 1947, the latest year for which details are available, net short-term capital gains reported by individuals amounted to only $165 million and were outweighed 30 to 1 by long-term capital gains. This is in sharp contrast to the division between long- and short-term capital gains in earlier years under longer holding periods. In the period 1938–41, under the 18-month holding period, long-term gains outweighed short-term by about 3 or 4 to 1 whereas the present ratio is many times that.

Lengthening the holding period to 1 year would thus contribute to the more effective taxation of speculative gains.

The use of a holding period is, of course, an imperfect approach to the problem of distinguishing speculation from investment. A holding period, in effect, conclusively presumes that unless the required

time elapses between the acquisition of an asset and its sale the transaction is not an investment. The concept is that the difference between an investor and a speculator is that the former is primarily interested in income possibilities of his investment, whereas the latter is primarily concerned with resale price; the longer one holds, the less important resale price tends to be in relation to total yield over the lifetime of the investment.

The advantage of a holding period over other methods of distinguishing speculation from investment is that it is a completely objective approach which is devoid of administrative and compliance difficulties.

A lengthening of the holding period to 1 year might be supported on another ground. One reason for special treatment of capital gains is to relieve the unfairness of taxing in a single year, and at progressive rates, gains accruing over more than 1 year. This reason does not support preferential tax treatment of gains from sales of property held less than 1 year.

In the testimony recently presented to your committee, those who objected to lengthening the holding period presented two arguments in support of their position. First, it was stated that lengthening the holding period would result in reduced revenues (and, conversely, shortening the holding period would produce increased revenues).

It was pointed out in this connection that, when the law provided a holding period of 18 months or longer, there was almost no revenue from capital gains. In 1938, the net revenue from capital gains was only $12 million and, in 1940 and 1941, capital losses more than offset capital gains. On the other hand, after the adoption of a 6-month holding period in 1942, revenues from capital gains rose substantially—to $266 million in 1943, $354 million in 1944, and $720 million in 1945.

It is significant, however, that from early 1937 until 1942, the stock market suffered a drastic decline. For example, the Dow-Jones average of 30 industrial stocks declined from a high of 188.40 in March 1937 to a low of 97.79 in April 1942, and from that point rose almost uninterruptedly to a high of 207.32 in June 1946. As will be indicated later, revenues from capital gains are highly correlated with the upward or downward trend of stock prices; it would appear, therefore, that the primary reason for the change in capital gains revenues over the period 1938 to 1946 was the change in stock prices. Moreover, undoubtedly a large part of the relatively high revenues from capital gains since 1942 resulted from an increase in the maximum effective rate on long-term capital gains from 15 to 25 percent.

Secondly, it was pointed out to the committee that a holding period of 1 year would lessen the possibility of hedging marketing operations with respect to this year's cotton crop.

There appears to be no evidence, however, that the holding periods of 1 year or longer in effect in all years prior to 1942 resulted in an inadequate volume of trading in commodity futures. For example, the volume of trading in wheat contracts in the year 1939–40 (when the holding period was 18 months) reached almost 8.4 million bushels, a volume which was 2.7 times the average volume for the years between 1942 and 1948, when the 6-month holding period was in effect. The volume of trading in cotton contracts in 1941–42 (the year immediately preceding the adoption of the 6-month holding period) was higher than in five out of the seven succeeding years.

Another approach to the more effective taxation of speculative

gains would be to return to the definition of "capital assets" which was in effect prior to 1934. The pre-1934 definition drew a distinction between investors in securities or other properties, who were accorded capital-gains treatment, and persons in the business of trading or speculating in securities or other properties, who were subjected to full rates. This distinction was based primarily upon the volume, frequency, and variety of the taxpayer's transactions in securities or commodity futures, the nature of the taxpayer's portfolio, and other factors relevant in determining whether the taxpayer was engaged in the trade or business of buying and selling securities or other properties.

III. Proposal for a Higher Alternative Rate

The Secretary's proposal to increase the maximum effective rate on capital gains to 37½ percent would apply to both individuals and corporations. At present levels of prices and business activity this would raise $295,000,000 of additional revenue in a full year at the proposed tax rates, about two-thirds coming from individuals and one-third from corporations.

This proposal would affect a comparatively small group of taxpayers. In 1947, only 69,000 or 4 percent of the total number of taxpayers reporting net capital gains used the alternative rate. However, owing to the concentration of capital gains among middle and upper incomes, this group accounts for a significant part of the entire capital gains tax base. In 1948, for example, about one-third of all the capital gains reported by individuals was in the alternative rate area and accounted for more than one-half the total capital gains tax collected from individuals.

The proposed rate increase would achieve a better alinement between the taxes on capital gains and ordinary income, as well as between the relative rates on capital gains in the lower and the higher income brackets. As indicated above, the great bulk of individual taxpayers having long-term capital gains do not have large enough incomes to make use of the alternative capital-gains rate. In their case, the rate of tax varies directly with the rates in force on ordinary income. Since 1948, the first bracket rate of individual income tax has risen from 16.6 percent to 20 percent, and under the President's program would be raised to 24 percent. This represents a 45-percent increase in the tax on both ordinary income and long-term capital gains paid by taxpayers in the lowest tax bracket. In contrast, unless the alternative rate of 25 percent is increased, those in the upper income brackets will pay the same rate of tax on their capital gains as they did under the 1948 act.

Representatives of the security and commodity exchanges asserted before your committee that increasing the capital-gains rate would cut the volume of gains realized and thus reduce rather than increase revenues. It is the conclusion of the staff that this assertion cannot be supported by the facts.

To reduce revenues, an increase from 25 to 37½ percent would have to reduce the volume of realized net gains (excess of gains over losses) by more than one-third.

Even more important, the gains realized by those whose incomes fall in brackets subject to rates below the 25-percent maximum rate will not be affected by the proposed increase. In recent years such gains have constituted well over half of statutory capital gains reported for tax purposes.

This is not to deny that, since the timing of realization is at the discretion of the taxpayer, capital-gains taxes affect the timing of security transactions. But it may be expected that investors will generally take their gains regardless of tax if they are convinced that they can maximize their profits by selling at high current prices rather than waiting until later when markets may be less favorable. Only where the accrued gain on an existing asset is relatively large and the prospective advantage to be gained from a switch is relatively small, will a capital-gains tax of the size recommended discourage the transaction.

Examination of the volume of capital gains reported on individual income tax returns suggests that year-to-year movements in these gains are more closely associated with changes in security prices than with changes in the capital gains tax. The following table shows for the period 1917 to 1947 (*a*) the excess of net capital gains over net capital losses reported on individual income tax returns with net income and (*b*) the index of monthly average prices of 416 industrial, utility, and railroad stocks compiled by Standard & Poor's Corp. The figures are presented graphically in the attached chart which shows the excess of gains or losses in billions of dollars on the left scale and the index of stock prices on the right scale.

The table and the chart indicate that, regardless of changes in the tax treatment of capital gains, increases in stock prices were generally accompanied by increases in the excess of gains over losses (or decreases in the excess of losses over gains). Conversely, decreases in stock prices were generally accompanied by increases in the excess of losses over gains (or decreases in the excess of gains over losses).

Capital gains and stock prices, 1917–51

Year	Excess of net capital gain over net capital loss reported on individual income tax returns with net income [1]	Stock price index (Standard & Poor's price of 416 stocks) (1935–39=100)	Year	Excess of net capital gain over net capital loss reported on individual income tax returns with net income [1]	Stock price index (Standard & Poor's price of 416 stocks) (1935–39=100)
	Millions of dollars			*Millions of dollars*	
1917	248.2	72.2	1935	37.5	82.9
1918	−68.1	64.1	1936	661.3	117.5
1919	262.8	74.6	1937	75.6	117.5
1920	−16.5	67.8	1938	30.8	88.2
1921	−639.1	58.3	1939	31.2	94.2
1922	231.8	71.5	1940	−79.7	88.1
1923	191.7	72.9	1941	−482.0	80.0
1924	1,036.9	76.9	1942	−301.1	69.4
1925	2,572.5	94.8	1943	1,120.6	91.9
1926	2,165.8	105.6	1944	1,656.3	99.8
1927	2,618.5	124.9	1945	[2] 3,645.6	121.5
1928	4,595.2	158.3	1946	[2] 5,651.9	139.9
1929	3,644.9	200.9	1947	[2] 3,653.9	123.0
1930	−120.6	158.2	1948	[3]	124.4
1931	−929.0	99.5	1949	[3]	121.4
1932	−1,651.7	51.2	1950	[3]	146.4
1933	−654.3	67.0	1951	[3]	[4] 171.2
1934	−459.3	76.6			

[1] Long-term gains and losses before percentage reduction.
[2] Taxable returns only, returns with no net income not available in this tabulation.
[3] Not available.
[4] Average first 3 months.

Sources: Excess of gains over losses 1917–44, unpublished manuscript by Dr. Lawrence H. Seltzer, The Nature and Tax Treatment of Capital Gains and Losses to be released shortly by the National Bureau of Economic Research; 1945–47, special tabulations made by the Bureau of Internal Revenue. Prices: Standard & Poor's Corp.

APPENDIX

I. Historical Development

The income tax since 1913 has considered capital gains to be income. This treatment has not had unqualified acceptance, however, and during most of the history of the income tax, preferential treatment has been accorded capital gains under a series of compromise methods.

Preferential taxation of capital gains, was introduced in 1921 to meet the criticisms that the full inclusion in 1 year's income of gains accrued over a number of years created inequitable burdens under graduated rates and deterred sales of appreciated property. Several different methods of meeting these criticisms have been tried (table 1).

From 1921 to 1934 assets held more than 2 years were subject to an alternative flat-rate tax of 12½ percent. This method reduced taxes by varying amounts for individuals subject to rates above 12½ percent depending upon the rates in the upper brackets. The advantage declined during the 1920's and increased as individual tax rates were revised upward in the 1930's.

In 1934 the treatment of capital gains of individuals was completely revised. They were made taxable as ordinary income under a schedule which in five steps included fractions of the gain declining from 100 percent on assets held 1 year or less to 30 percent on assets held more than 10 years. The result was that in 1934 capital gains were taxable to individuals in the highest bracket at rates ranging from 56 percent to about 17 percent. The multiple-holding periods were modified in 1938 and abandoned in 1942.

The present treatment of long-term capital gains and losses of individuals represents a combination of the alternative rate method applied in the 1920's and the system of percentage exclusions introduced in 1934. Long-term gains are included in ordinary income, but only to the extent of 50 percent, and are subject to a maximum rate limitation of 50 percent. The 50-percent rate is now reached at $18,000 of taxable income for a single individual or a married person filing a separate return and $36,000 for a married couple filing a joint return.

Table 2 shows the variation in rates on different incomes for a married couple filing a joint income tax return under present law. This table indicates that the marginal rate of tax applicable to long-term capital gains under present law is half the rate on ordinary incomes for a married couple with no dependents earning less than $36,000 after deductions and exemptions. At higher income levels, the capital gains rate is considerably less than half the rate on ordinary incomes. For example, at the $500,000 level it amounts to only 27.5 percent of the rate applicable to ordinary income.

Table 3 shows for a married couple with no dependents the maximum rates of tax on net capital gains from assets held more than 2 years and the levels of surtax net income at which these rates applied in the years 1922–51. This breaking point at which the maximum rate applied has been as low as $12,000 (in 1941) and as high as $44,000 (in 1938–39 and 1948–49).

Changes in the actual rates of tax from 1922 to 1951 on gains from the sales of capital assets held for varying periods of time are shown in table 4. For illustrative purposes, the computations in this table were made for a taxpayer whose total income amounts to $150,000 of which $50,000 is received in the form of statutory capital gains. At this level of income the rate applicable to gains from capital assets held for more than one-half year but not more than 1½ years has been as high as 69 percent (in 1941) and never lower than 24 percent (in 1929). For such a taxpayer, the 25-percent rate in effect since 1942 was exceeded in all prior years except for the period 1925–31.

Preferential treatment of gains was followed by the placing of limitations on the allowance of capital losses. In 1924 the rate of tax reduction for long-term losses was limited to 12½ percent, which was the maximum rate on long-term gains.

In order to meet the problem of revenue loss resulting from the decline in security prices in the early 1930's, further limitations were placed on the deduction of capital losses from ordinary income.

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At present long-term losses, like long-term gains, are 50 percent taken into account. The excess of statutory net capital losses over gains may be offset by individual taxpayers against ordinary income in any taxable year up to a maximum of $1,000. Any remaining unused capital losses may be carried forward into the five succeeding years as a short-term loss. Consequently, the maximum amount of net capital loss on one transaction that can be offset against ordinary income is $6,000.

II. Characteristics of the Tax Base

In 1947, the latest year for which data are available, 2.5 million individual income tax returns, slightly less than 5 percent of the total number filed, reported either net capital gains or losses. Returns with net gains outnumbered those with net losses more than 3 to 1. Total net capital gains realized by individuals filing tax returns in 1947 amounted to $5 billion while net losses amounted to $900 million.[1]

The net gain or loss from capital assets reported on returns with net gains and on returns with net loss in 1947 were as follows:

[In millions]

	Net gain	Net loss		Net gain	Net loss
Returns with net gain:			Returns with net losses:		
Short term	$151.6	$39.7	Short term	$13.1	$168.3
Long term:			Long term:		
Statutory amount	2,361.2	6.0	Statutory amount	60.3	333.2
Face value	4,722.5	12.0	Face value	120.6	666.4

Special tabulations made by the Bureau of Internal Revenue for the year 1947 permit a comparison of the distribution by adjusted gross income size classes of total statutory net gain or loss from capital assets. Long-term capital gain and loss are taken after the 50 percent statutory exclusion, but before the limitation of losses to $1,000. The following percentage distribution shows that the distribution of gains and losses by income classes was roughly parallel, although the excess of gain over loss for top income classes was more marked than for the lower income classes.

Adjusted gross income size class	Percentage of total statutory net gain or loss	
	Net gain	Net loss before $1,000 limitation
Under $5,000	29.3	26.47
$5,000 to $10,000	17.3	16.2
$10,000 to $25,000	15.3	20.0
$25,000 to $100,000	15.4	15.1
Over $100,000	16.1	3.5
Total taxable	93.4	81.1
Nontaxable	6.6	18.9
Grand total	100.0	100.0

The capital gains and losses realized in any given year will have accrued for varying periods of time, ranging from a few days to many years. Although no recent information on the age distribution of capital gains is available, data for the period 1934–37, when capital gains were taxed on the basis of graduated holding periods, show that more than one-fourth of all capital gains was from assets held for more than 10 years.

[1] Both figures are before the statutory reduction of 50 percent in long-term capital gains and losses under present law.

Percentage distribution of net capital gain by period capital assets were held prior to sale or exchange, 1934–37

	Under 1 year	1 to 2 years	2 to 5 years	5 to 10 years	Over 10 years
	Percent	*Percent*	*Percent*	*Percent*	*Percent*
1934	29.4	17.1	11.5	10.1	29.2
1935	30.3	14.1	17.3	9.7	26.3
1936	31.9	13.0	21.2	10.5	22.9
1937	12.1	12.3	27.4	16.9	29.8

While the total number of returns with net capital gains and the amount of net capital gains reported have fluctuated widely from year to year, the percentage of these totals which falls in the income brackets subject to the alternative tax appears to be relatively stable. During the years 1942 to 1947, only about 4 to 5 percent of all taxpayers reporting net capital gains were subject to the alternative tax. However, the amounts subject to alternative tax, though declining from almost 42 percent of all net gains reported in 1942 to less than 30 percent in 1947, represented a very considerable portion of the tax base. The detailed figures are shown in table 5.

The relative importance of the excess of statutory net capital gains over statutory net capital losses (even after limiting the deduction of losses to $1,000) is small when compared to aggregate adjusted gross income reported on tax returns. In 1948, the last year for which published preliminary figures are available, statutory capital gains on taxable returns exceeded losses by $2.2 billion while adjusted gross income amounted to $163.5 billion. The excess of statutory capital gains over losses accounted for only 1.3 percent of adjusted gross income.

It is important to note, however, that capital gains account for a much higher percentage of total income in the middle and upper income classes. Table 6 shows the relative importance of capital gains as a share of total income for selected adjusted gross income classes, for the years 1945–48. The portion of total income received in the form of capital gains is insignificant in the brackets below $5,000 of adjusted gross income, but its importance increases as income increases. In 1946, almost one-fourth of the total income in the top brackets was received in the form of capital gains. Following the stock market decline in 1946, capital gains accounted for a smaller proportion of total income in the higher income classes. In 1947 and 1948, they amounted to 18.6 and 14.3 percent, respectively, of adjusted gross incomes above $100,000.

III. Revenue Importance of the Capital Gains Tax

Estimates of the net tax revenue derived directly from capital gains and losses, both of individuals and corporations, are given in table 7.

TABLE 1.—*Individual income tax treatment of gains and losses from sales or exchanges of capital assets under the Revenue Acts of 1922 through 1950* [1]

Federal tax law	Income year	Provisions with respect to—			
		Assets by period held	Percent of gain or loss taken into account in computing net income	Tax on net gain taken into account	Loss offsets, limitations, and carry-overs
Revenue Act of—					
1921	1922, 1923	More than 2 years	100	At the election of the taxpayer, capital net gains were taxable at 12½ percent in lieu of the normal and surtax rates; but if such election were made, the total tax, including the tax on capital net gains, could in no case be less than 12½ percent of the total net income.[2]	Capital losses allowed in full against income of any kind.
1924	1924	do	100	At the election of the taxpayer, capital net gains were taxable at 12½ percent in lieu of the normal and surtax rates.	Capital losses could be segregated from ordinary net income, and a tax credit of 12½ percent of the capital net loss taken, but in no case could the tax be less than the tax (computed at normal and surtax rates) would be if the capital net loss were deducted from ordinary net income.
1926	1926, 1927	do	100	Same as 1924	Same as 1924.
1928	1928–31	do	100	do	Do.
1932	1932, 1933	do	100	do	Do.
1934–36	1934–37	1 year or less	100	Net capital gains to the extent thus recognized were included in net income subject to full normal and surtax rates.	Net capital losses computed on basis of foregoing percentages were allowed in determining net income to the extent of the recognized capital gains plus $2,000.
		Over 1 year, not over 2 years	80		
		Over 2 years, not over 5 years	60		
		Over 5 years, not over 10 years	40		
		Over 10 years	30		
Revenue Act of 1938 and Internal Revenue Code	1938–41	Short-term: Not more than 18 months.	100	Net short-term gain fully taxable at normal and surtax rates. In 1940 defense tax also applied.	Short-term loss allowed only to the extent of short-term gain. Loss disallowed in one year (to an amount not in excess of net income) carried forward and applied against net short-term gain of the succeeding year.

		Long-term:			
		More than 18 months but not more than 24 months	66⅔	Net long-term gain either included with other income subject to normal and surtax rates or segregated and taxed at 30 percent, whichever method results in the lesser tax. In 1940 defense tax also applied.	Long-term loss allowed against long-term gain. Net long-term loss either deducted from other income (including net short-term gain) or 30 percent of net loss credited against tax on other income, whichever method results in the greater tax. No long-term loss carry-over.
		More than 24 months	50		
Internal Revenue Code as amended by Revenue Act of 1942.	1942	Short-term: Not more than 6 months	100	Net short-term gain (reduced by net long-term loss taken into account) fully taxable at normal and surtax rates.	Short-term loss combined with long-term loss taken into account allowed to the extent of (1) short-term gain, (2) long-term gain taken into account, and (3) other income up to $1,000. Balance of combined short- and long-term net loss carried forward for 5 years as short-term loss. The amount of the net capital loss carry-over may not be included in computing a new capital loss of a taxable year which can be carried forward to the next 5 succeeding taxable years.
		Long-term: [3] More than 6 months	50	Net long-term gain (reduced by net short-term loss) either included with other income subject to normal and surtax rates or segregated and taxed at 50 percent, whichever method results in the lesser tax.	

[1] For taxable years beginning after Dec. 31, 1949, capital gains of nonresident aliens, not engaged in trade or business in the United States but temporarily present here, are subject to tax. In the case of those present in the United States for less than 90 days, the tax applies only to gains realized from transactions effected during their presence. In the case of those present in the United States for 90 days or more, the tax applies to all their gains from transactions in this country during the taxable year whether or not they were present when the gain was realized.

[2] Under the Revenue Act of 1921, capital assets were limited to assets acquired and held for profit or investment. The limitation was removed by the Revenue Act of 1924.

[3] For treatment of property used in trade or business and certain involuntary conversions, see sees. 117 (j) and 117 (k) of Internal Revenue Code, as amended by Revenue Acts of 1942 and 1943.

TABLE 2.—*Marginal rates applicable to ordinary income and to long-term capital gains of a married couple with no dependents at various levels of surtax net income under present law*

Surtax net income	Rate of tax on 1 additional dollar of ordinary income	Rate of tax on 1 additional dollar of long-term capital gains	Capital gains rate as a percent of regular rate
	Percent	*Percent*	*Percent*
$2,000	20.0	10.0	50.0
$5,000	22.0	11.0	50.0
$10,000	26.0	13.0	50.0
$25,000	43.0	21.5	50.0
$36,000	53.0	25.0	47.2
$100,000	75.0	25.0	33.3
$500,000	91.0	25.0	27.5

TABLE 3.—*Maximum effective rates of tax on net capital gains from assets held over 2 years and level of surtax net income at which these rates applied, 1922–51*

Income year	Maximum effective rates of tax on net capital gains from assets held over 2 years	Amount of surtax net income at which the ordinary rates exceed the maximum effective rate on net capital gains from assets held over 2 years [1]	Income year	Maximum effective rates of tax on net capital gains from assets held over 2 years	Amount of surtax net income at which the ordinary rates exceed the maximum effective rate on net capital gains from assets held over 2 years [1]
	Percent			*Percent*	
1922	12.5	$16,000	1938	15	$44,000
1923	[2] 9.375	16,000	1939	15	44,000
1924	12.5	24,000	1940	15	22,000
1925	12.5	28,000	1941	15	12,000
1926	12.5	28,000	1942	25	18.000
1927	12.5	28,000	1943	25	18,000
1928	12.5	28,000	1944	25	16,000
1929	12.5	32,000	1945	25	16,000
1930	12.5	28,000	1946	25	18,000
1931	12.5	28,000	1947	25	18,000
1932	12.5	16,000	1948	25	[4] 44,000
1933	12.5	16,000	1949	25	[4] 44,000
1934	[3]		1950	25	[4] 40,000
1935			1951	25	[4] 36,000
1936					
1937					

[1] To take account of the 50 percent exclusion, the amounts shown for the years 1938 through 1951 are the lower limits of the surtax net income brackets at which the combined marginal normal tax and surtax rates exceed twice the maximum effective rate on net capital gains.

[2] Taking into account 25 percent reduction in tax provided under sec. 1200 (a), Revenue Act of 1924.

[3] The following percentages of net capital gains were included in net income and taxed at the normal tax and surtax rates: For assets held over 2 years but not over 5 years, 60 percent; over 5 years but not over 10 years, 40 percent; over 10 years, 30 percent. For detailed rates of tax on statutory capital gains of $50,000 received by individuals with surtax net income of $100,000, by length of period held, see table 4.

[4] Assumes taxpayer is married and files a joint return. For single persons and married persons filing separate returns, the amount would be $22,000 for the years 1948 and 1949, $20,000 for the year 1950, and $18,000 for the year 1951.

TABLE 4.—*Rates of tax on statutory capital gain of $50,000 received by individuals with surtax net incomes of $100,000, by length of period held, 1922–51*

Income year	Length of period held (years)						
	0–½	½–1	1–1½	1½–2	2–5	5–10	Over 10
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
1922	56.0	56.0	56.0	56.0	12.5	12.5	12.5
1923 [1]	42.0	42.0	42.0	42.0	9.375	9.375	9.375
1924	43.0	43.0	43.0	43.0	12.5	12.5	12.5
1925–28	25.0	25.0	25.0	25.0	12.5	12.5	12.5
1929	24.0	24.0	24.0	24.0	12.5	12.5	12.5
1930–31	25.0	25.0	25.0	25.0	12.5	12.5	12.5
1932–33	56.0	56.0	56.0	56.0	12.5	12.5	12.5
1934–35	56.0	56.0	44.8	44.8	33.6	22.4	16.8
1936–37	62.0	62.0	49.6	49.6	37.2	24.8	18.6
1938–39	62.0	62.0	62.0	20.0	15.0	15.0	15.0
1940 [2]	68.2	68.2	68.2	22.0	16.5	16.5	16.5
1941	69.0	69.0	69.0	20.0	15.0	15.0	15.0
1942–43 [3]	85.0	25.0	25.0	25.0	25.0	25.0	25.0
1944–45	92.0	25.0	25.0	25.0	25.0	25.0	25.0
1946–47	84.55	25.0	25.0	25.0	25.0	25.0	25.0
1948–49	[4] 71.28	25.0	25.0	25.0	25.0	25.0	25.0
1950	[4] 73.71	25.0	25.0	25.0	25.0	25.0	25.0
1951	[4] 81.00	25.0	25.0	25.0	25.0	25.0	25.0

[1] Taking into account 25 percent reduction in tax provided under sec. 1200 (a), Revenue Act of 1924.
[2] Includes 10 percent defense tax.
[3] Excludes Victory tax applicable to 1943 incomes.
[4] Assumes taxpayer is married and files a joint return. For single persons and married persons filing separate returns, the rate would be 80.32 percent in 1948 and 1949, 82.50 percent in 1950, and 89 percent in 1951.

TABLE 5.—*Number of returns and net capital gains subject to alternative tax, taxable individual income tax returns, 1942–47*

[Dollar amounts in thousands]

Year	Total number of returns with net capital gains	Returns with net capital gains subject to alternative tax		Total net capital gains	Net capital gains subject to alternative tax	
		Number	Percent of total number with net capital gains		Amount	Percent of total net capital gains
1942	277,539	12,507	4.5	$303,672	$127,552	42.0
1943	638,004	31,850	5.0	770,849	287,856	37.3
1944	983,492	51,993	5.3	1,109,344	368,354	33.2
1945	1,583,347	88,485	5.6	2,245,580	779,116	34.7
1946	1,975,105	84,021	4.3	3,157,809	922,758	29.2
1947	1,624,931	69,444	4.3	2,290,706	677,738	29.6

Source: Statistics of Income, pt. 1, 1942–47.

TABLE 6.—*Relative importance of statutory net capital gains and losses at various income levels, as reported on taxable individual income tax returns, 1945–48*

[Money figures in millions of dollars]

Adjusted gross income class	Adjusted gross income	Sales or exchanges of capital assets			
		Net gain	Net loss (after statutory limitations)	Excess of net gain over net loss	
				Amount	As percent of adjusted gross income
1945					
Under $5,000	$88,486.9	$600.2	$96.4	$503.8	0.6
$5,000 to $10,000	12,273.2	374.5	29.5	345.0	2.8
$10,000 to $25,000	8,789.8	427.2	27.0	400.2	4.6
$25,000 to $100,000	6,285.5	475.5	11.5	464.0	7.4
$100,000 and over	1,726.2	368.0	1.1	366.9	21.3
Total	117,561.7	2,245.6	165.5	2,080.1	1.8
1946					
Under $5,000	82,217.3	964.8	97.6	867.2	1.1
$5,000 to $10,000	15,288.5	585.2	44.1	541.1	3.5
$10,000 to $25,000	10,999.3	550.3	41.4	508.9	4.6
$25,000 to $100,000	7,478.5	550.8	19.1	531.7	7.1
$100,000 and over	2,066.4	506.7	1.5	505.2	24.4
Total	118,050.0	3,157.8	203.7	2,954.1	2.5
1947					
Under $5,000	95,712.6	720.6	110.4	610.2	.6
$5,000 to $10,000	18,433.6	425.1	53.0	372.1	2.0
$10,000 to $25,000	11,602.5	374.9	49.0	325.9	2.8
$25,000 to $100,000	7,449.2	377.8	23.7	354.1	4.8
$100,000 and over	2,104.0	393.6	2.0	391.6	18.6
Total	135,301.9	2,292.0	238.1	2,053.9	1.5
1948					
Under $5,000	85,454.9	453.1	88.9	364.2	.4
$5,000 to $10,000	29,818.3	489.2	58.2	431.0	1.4
$10,000 to $25,000	13,972.5	445.4	52.4	393.0	2.8
$25,000 to $100,000	9,753.9	434.3	30.1	404.2	4.1
$100,000 and over	3,057.3	440.8	3.3	437.5	14.3
Total	142,056.9	2,262.9	232.9	2,030.0	1.4

NOTE.—Figures are rounded and will not necessarily add to total.

Source: Statistics of Income, pt. 1, 1945–48.

TABLE 7.—*Estimated revenue yield from capital gains and income taxation, 1926–51*

[Dollar amounts in millions]

Year of liability	Individuals			Corporations			Individuals and corporations		
	Total individual income taxes [1]	Estimated tax on capital gains and losses		Total corporation income and excess profits taxes [1]	Estimated tax on capital gains and losses		Total income and excess profits taxes [1]	Estimated tax on capital gains and losses	
		Amount [2]	Percent of total tax		Amount [2]	Percent of total tax		Amount [2]	Percent of total tax
1926	$732	$225	30.7						
1927	831	297	35.7						
1928	1,164	576	49.5						
1929	1,002	421	42.0						
1930	477	−15	−3.1	$712	−$5	−0.7	$1,189	−$20	−1.7
1931	246	−89	−36.2	399	−77	−19.3	645	−166	−25.7
1932	330	−80	−24.2	286	−93	−32.5	616	−173	−28.1
1933	374	16	4.3	423	−87	−20.6	797	−71	−8.9
1934	511	17	3.4	596	2	.3	1,107	19	1.7
1935	657	72	11.0	735	31	4.2	1,392	103	7.4
1936	1,214	171	14.1	1,191	67	5.6	2,405	238	9.9
1937	1,142	41	3.6	1,276	25	2.0	2,418	66	2.7
1938	766	12	1.6	860	22	2.6	1,626	35	2.2
1939	929	4	.4	1,232	25	2.0	2,161	29	1.3
1940	1,496	−7	−.5	2,549	−49	−1.9	4,045	−56	−1.4
1941	3,908	−86	−2.2	7,168	−164	−2.3	11,076	−250	−2.3
1942	8,927	68	.8	12,256	42	.3	21,183	110	.5
1943	[3] 14,590	266	1.8	15,926	69	.4	30,516	335	1.1
1944	16,347	354	2.2	14,884	100	.7	31,231	454	1.5
1945	17,226	721	4.2	10,795	214	2.0	28,021	935	3.3
1946	16,281	893	5.5	8,875	270	3.0	25,156	1,163	4.6
1947	18,249	644	3.5	10,981	210	1.9	29,230	854	2.9
1948	[4] 15,618	528	3.4	11,920	190	1.6	27,538	718	2.6
1949	[5] 15,430	475	3.1	9,800	190	1.9	25,230	665	2.6
1950	[5] 18,700	780	4.2	17,000	270	1.6	35,700	1,050	2.9
1951	[5] 24,100	890	3.7	22,600	330	1.5	46,700	1,220	2.6

[1] As reported in Statistics of Income.

[2] The estimated tax on capital gains and losses is not intended to show the difference in tax revenue resulting from taxing capital gains and losses as compared with not levying such a tax in the specified year. The estimated tax on capital gains and losses for each of the specified years is the difference between (1) the total individual and corporation income taxes reported in Statistics of Income, and (2) the total of such taxes which would have been realized if capital gains and losses had been entirely excluded from the tax computation.

[3] Excludes additions to liability under the Current Tax Payment Act of 1943 amounting to $2,555,894,000.

[4] Preliminary.

[5] Estimated.

NOTE.—It should be borne in mind, when interpreting this table, that the estimates of revenue yield from capital gains taxation of individuals during the period 1926–34 are not strictly comparable with those for 1935 and later years. In preparation of the estimates for the earlier period, no account was taken of deficit returns; averages of capital gains by income size classes were used to approximate the effective rates at which gains were presumed to have been taxed. For the period since 1935 deficit returns have been included and better account has been taken of the dispersion of capital gains and losses within income size classes. Therefore, it is believed that the estimates since 1935 are much more nearly accurate than those for the preceding period. Lack of proper information makes it inadvisable to attempt to put the estimates before 1935 on the same basis as those subsequent. In general, the effect of including deficit returns is consistently to diminish gains and increase losses. The 1926–34 estimates of capital gains tax revenue from individuals are therefore overstated in comparison with later years.

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